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March 21, 1995

William F. Caton, Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

ORIGINAL

Re: Price Cap Performance Review
for Local Exchange Carriers --
CC Docket No. 94-1 (Ex parte filing)

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Dear Sir:

On behalf of AT&T Corp. ("AT&T"), I am submitting for filing in the above-referenced proceeding this reply to the United States Telephone Association's ("USTA's") ex parte filing dated March 16, 1995, which purports to quantify the impact of "outright errors" that USTA has previously alleged in AT&T's direct model for determining the price cap LECs' productivity.¹ AT&T has already shown that there is no substance to USTA's contentions about the purported deficiencies in AT&T's direct model.² As explained below, USTA's latest claims, like its prior assertions, are entirely unfounded.³

¹ See letter dated February 9, 1995 from Mary McDermott, USTA, to William F. Caton, FCC.

² See letter dated March 10, 1995, from Bruce K. Cox, AT&T, to William F. Caton, FCC ("March 10 ex parte"). USTA's March 16 ex parte largely ignores AT&T's rebuttal of its allegations concerning the direct model.

³ The lack of merit to USTA's criticisms should be apparent merely from their timing. AT&T's direct model was submitted to the Commission last November, yet USTA waited until this past February 9 before identifying the alleged fundamental mistakes in that

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First, USTA claims (p. 2) that AT&T erroneously calculated the rate of return achieved by the Bell Operating Companies ("BOCs") for the 1991-1993 period. As a result, USTA claims (id.) that AT&T overstated the "realized X factor" by 0.6. Like many of USTA's criticisms, this claim does not relate to the direct model at all; rather, as AT&T has repeatedly shown, it addresses AT&T's Comments in this proceeding filed May 9, 1994, which used a different methodology for calculating BOC earnings.⁴

Because official data is not reported for price cap tariff periods (i.e., from July 1 to the following June 30), AT&T was required to develop this information to analyze the LECs' performance under price caps. The AT&T direct model, submitted in November 1994, included an appendix explaining the derivation of price cap tariff period investment.⁵ USTA has not attempted to show any deficiency in this procedure. USTA's further claim that AT&T used "overstated" estimates of LEC 1994 earnings is likewise misplaced. AT&T's direct model did not rely on estimates of LEC 1994 earnings. Instead, AT&T used the actual earnings for the period under analysis in the model (i.e., the first and second quarters of 1994). USTA apparently would have had AT&T use projections of total 1994 earnings, which were not available in the public record and which in all events are irrelevant to the time period at issue in the direct model.

Second, USTA asserts (p.2) that AT&T's "original calculations" omitted LECs other than the BOCs,

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model, and held back its quantification of those supposed errors until last week. If AT&T's model had in fact been as transparently flawed as USTA now claims, it would have long since shown those errors instead of waiting until the eve of the Commission's order before airing these charges.

⁴ See letter dated September 1, 1994 from Bruce Cox, AT&T, to William F. Caton, FCC; letter dated November 29, 1994 from Richard N. Clarke, AT&T, to William F. Caton, FCC ("November 29 ex parte"). AT&T's direct model used average net investment ("ANI") data derived from ARMIS reports to determine the test X factor.

⁵ See November 29 ex parte, Appendix A, Attachment 3.

thereby allegedly overstating the implied productivity offset. This is yet another instance of USTA's efforts to confuse the issue by attacking earlier versions of AT&T's direct model.⁶ USTA does not dispute that AT&T's direct model submitted to the Commission in November 1994 contained data on all price cap LECs. The results of that model indicate a derived test X factor of 5.54 percent. Thus, despite USTA's criticism inclusion of data on all price cap LECs in AT&T's methodology points to a considerable understatement of the current productivity offset.⁷

Third, USTA asserts (pp. 3-4) that AT&T "disregarded or incorrectly applied" the Commission's price cap formula to the "two separate half-year periods" allegedly included in the direct model. This erroneous claim largely rehashes a criticism leveled in USTA's February 9 ex parte, which AT&T has previously rebutted.⁸ To recapitulate, there is only one "half-year period" of data -- namely, the period January-June 1991 -- in AT&T's November 29 version of the direct model. Moreover, AT&T's development of the test X based on that data is fully consistent with the Commission's price cap regime, which did not prescribe either the applicable GNP-PI or a productivity offset during that period. Indeed, if AT&T had applied the exact rules to that half-year period, the resultant test X would have been even larger than the figure actually derived by the direct model.⁹ Thus, it

⁶ USTA's criticism of AT&T's earlier submission is also unjustified. As USTA acknowledges (p.2), AT&T stated that it was unable to include non-BOCs in that version of the model because computer-readable data for all price cap LECs was not then available. USTA asserts (id.) that AT&T's explanation "lacks credibility," but does not justify this claim or show (as it cannot) that computer-readable data were in fact available for these LECs.

⁷ USTA also asserts (p. 3 n 6) that AT&T's revised model is "still plagued by the other errors" USTA has claimed in the direct model. As AT&T showed in its March 10 ex parte, and shows again here, there are no such errors.

⁸ See March 10 ex parte, p 2 n.2.

⁹ USTA's criticism of the 2.0 percent GNP-PI adjustment AT&T used for the January-June 1991 period is likewise misplaced. Although the GNP-PI for the July 1991 price cap filing was 4.8 percent, as USTA points out (p. 3), that figure would have

is at best unclear why USTA continues to raise this purported "criticism" of AT&T's November 1994 model.

Finally, USTA erroneously claims (p. 4) that AT&T inflated the LECs' reported earnings by "imputing revenues that were never earned" by those carriers, i.e., the amounts by which the LECs priced below their caps. AT&T has already fully addressed this criticism in its March 10 ex parte filing and shown that USTA's claim is baseless.¹⁰ AT&T has not sought to "impute" unearned revenues to the price cap LECs, and it recognizes that a number of those carriers are currently pricing below their caps. What AT&T's direct model shows, however, is that such "under cap" pricing might well have been less prevalent had the test X been incorporated in the price cap formula from the outset of the LEC price cap plan.

In sum, USTA's latest replowing of the same ground has again failed to demonstrate that there is any defect in AT&T's November 1994 direct model, much less that the model is "conceptually incorrect and contain[s] computational mistakes" as USTA claims (p. 4) in its March 16 ex parte. USTA's willingness to reargue these same contentions is perhaps not surprising, since by reiterating these claims it has again avoided addressing the many deficiencies in its own total factor productivity ("TFP") study that AT&T and other parties have previously demonstrated. Because those serious criticisms still stand unrebutted in the record, the Commission should conclude that USTA's TFP methodology is unacceptable as a basis for determining the LEC productivity offset.

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had no bearing in the context of a July 1990 price cap filing. Rather, under the Commission's price cap formula the applicable GNP-PI for such a filing would have been the 1989-90 rate reported by the Commerce Department, which was 4.0 percent. This equates to the 2.0 percent rate for a half-year, as used in AT&T's methodology.

¹⁰ See March 10 ex parte, pp. 1-2. Specifically, as noted there the direct model derives test values for the PCI and X using a ratio of actual and test revenues; this process necessarily requires that the model derive the amount of revenues that could have been produced at the LECs' actual PCI (which includes the amount by which those carriers were below cap).

Two copies of this ex parte filing are being submitted in accordance with Section 1.1206 of the Commission's rules. Please include this filing in the public record of these proceedings.

Respectfully submitted,

Bruce K. Cox

cc: Kathleen Wallman
Richard Metzger
Michael Katz
David Nall
Mark Uretsky
Anthony Bush
Alexander Belinfante
Lauren Belvin
Karen Brinkmann
James Casserly
James Coltharp
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